Senate Budget and Fiscal Review—Denise Moreno Ducheny, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Mike Machado, Chair
Senator Robert Dutton
Senator Christine Kehoe

Tuesday, May 22, 2007
10:00 a.m.
Room 2040
Consultant: Bryan Ehlers

"B" AGENDA

(continued on following page)

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

Appendices

A	Trailer Bill to authorize direct transfer to the State Controller of payment for services rendered under the California Automated Travel Reimbursement System program
B	STO Description of New General Fund Revenue
C	Technology Identification and Development of a Collaborative Strategy—April 27th, 2007 letter from the Fed/State Partnership to the Legislative Analyst's Office

Departments with Issues Proposed for Vote-Only

0650 Office of Planning and Research

The Office of Planning and Research (OPR) assists the Administration with legislative analysis and planning, policy research, and liaison with local governments. The OPR also oversees programs for small business advocacy, rural policy, and environmental justice. In addition, the office has responsibilities pertaining to state planning, California Environmental Quality Act assistance, environmental and federal project review procedures, and overseeing the California Service Corps.

The Governor's budget funds 91.3 positions (including 19 new positions) and expenditures as follows:

Summary of Expenditures (dollars in thousands)	2006-07	2007-08	$ Change	% Change
Fund Source				
General Fund	$10,263	$10,436	$173	1.7%
Federal Trust Fund	38,312	38,405	93	0.2
Reimbursements	2,217	3408	1,191	53.7
Total	$50,792	$52,249	$1,457	2.9%

VOTE-ONLY ISSUE:

1. Office of the Small Business Advocate. The OPR requests $234,000 General Fund and two positions to fund the Office of the California Small Business Advocate (CSBA). Prior to the disestablishment of the Office of Trade and Commerce in 2002, the Office of the CSBA was transferred to the OPR. The OPR has performed the duties of the CSBA over the last five years by periodically establishing a CSBA and funding it from existing resources. However, the OPR believes that 2006 legislation adding new responsibilities for the CSBA to study the effects of state regulation on small businesses and to develop an emergency preparedness handbook necessitates ongoing funding.

Staff Comment: The Subcommittee denied this BCP at the March 8, 2007, hearing; however, the Chair requested additional workload data and indicated the issue might be reconsidered at a later date. The OPR subsequently responded to the Chair with a letter addressing the Subcommittee's concerns.

Staff Recommendation: RESCIND the previous action and APPROVE as budgeted.

VOTE:

0890 Secretary of State

The Secretary of State (SOS), a constitutionally established office, is the chief election officer of the state and is responsible for the administration and enforcement of election laws. The office is also responsible for the administration and enforcement of laws pertaining to filing documents associated with corporations, limited partnerships, and the perfection of security agreements. In addition, the office is responsible for the appointment of notaries public, enforcement of notary law, and preservation of certain records with historical significance. All documents filed with the office are a matter of public record and of historical importance. The Secretary of State's executive staff determines policy and administration for Elections, Political Reform, Business Programs, Archives, and Information Technology and Management Services Divisions.

The Governor's budget funds 477.3 positions (including 15.0 new positions) and budget expenditures of $92.6 million ($36.2 million General Fund).

VOTE-ONLY ISSUE:

1. May Revise Letter: Funding to Conduct the February 2008 Presidential Primary Election. The SOS requests $11.7 million (General Fund) to fund the additional costs associated with Chapter 2, Statutes of 2007 (SB 113), which requires a presidential primary election be held in February 2008. The funds would be used to provide California voters with an adequate supply of voter registration cards (VRCs) and state ballot pamphlets, and to conduct election night reporting and provide state support (including overtime for staff to gather and post the election night results).

Staff Comments: Historically, the SOS has conducted one statewide election per fiscal year; however, SB 113 requires a presidential primary in February 2008 in addition to the statewide primary election to be held in June 2008. The requested funding is based on the SOS's best estimates of the length of the ballot pamphlets and the number of VRCs that will be needed. Staff notes that the final cost of the election is highly contingent upon two factors that are subject to change: (1) the length of the ballot pamphlet—which is contingent upon the number of initiatives that qualify for the ballot and will not be known until 85 days before the election; and (2) the number of VRCs needed—which depends largely on the magnitude and extent of voter outreach activities. Therefore, a supplemental appropriation may eventually be necessary to fully fund the election.

Staff Recommendation: APPROVE the request.

VOTE:

9210 Local Government Financing

The Local Government Financing budget items provide certain types of general financing and law enforcement grants to local governments. Proposed spending in 2007-08 is $294.3 million (all General Fund)—essentially the same as in the current year. The large reduction of $1 billion in the current year, compared with 2005-06 is due to $1.2 billion of one-time funding provided in 2005-06 to make local governments whole for the Vehicle License Fee "Gap Loan."

VOTE-ONLY ISSUE:

1. Trailer Bill Language: Technical Amendment to Booking Fee Statute.

Staff Comments: Due to an inadvertent deletion of code section, under existing statute the County of San Diego would receive booking fee payments twice—once from the state and once from the City of San Diego. Trailer Bill Language should be adopted to fix the statute so that the City of San Diego pays the County of San Diego and the state reimburses the City of San Diego for the booking fees.

Staff Recommendation: APPROVE Trailer Bill Language.

VOTE:

Departments with Issues Proposed for Discussion

0840 State Controller

The State Controller is the Chief Financial Officer of the state. The primary functions of the State Controller's Office (SCO) are to provide sound fiscal control over both receipts and disbursements of public funds; to report periodically on the financial operations and condition of both state and local government; to make certain that money due the state is collected through fair, equitable, and effective tax administration; to provide fiscal guidance to local governments; to serve as a member of numerous policy-making state boards and commissions; and to administer the Unclaimed Property and Property Tax Postponement Programs. The Governor's budget funds 1,234.5 positions (including 136.4 new positions) and $172 million in expenditures.

VOTE-ONLY ISSUES:

1. April Finance Letter: California Child Support Automation System (CCSAS) Audits. The SCO requests 2.0 one-year, limited-term positions and $192,000 (Reimbursement Authority) to fulfill CCSAS responsibilities.

2. Trailer Bill Language: Direct Transfer of California Automated Travel Reimbursement System (CalATERS) Payments to the SCO. The Administration proposes trailer bill language (see Appendix A) to authorize direct transfer to the SCO of CalATERS payments (from departments).

STAFF RECOMMENDATION ON VOTE-ONLY ISSUES 1 and 2: APPROVE as requested.

VOTE:

DISCUSSION ISSUES:

1. BCP: Salary Increase for Staff Management Auditors. The SCO requests $224,000 ($106,000 General Fund) to support a five percent salary increase for the Staff Management Auditor (Specialist). The SCO has experienced significant recruitment and retention problems because of unfavorable Staff Management Auditor salary comparisons between the SCO and other state and local agencies.

Staff Comments: This issue was heard previously and the Chair held it open to provide maximum opportunity for the collective bargaining process to work. To date, the SCO indicates the DPA has approved the proposed auditor salary increase, and all other departments who use this classification plan to absorb the additional costs. However, staff notes that the salary increase has not received final union approval.

Staff Recommendation: DENY the request.

VOTE:

2. May Revise Letter: Human Resource Management System (HRMS) – 21st Century Project. The SCO requests a one-year limited-term position, a $996,000 General Fund increase, and a $536,000 reduction in Federal Funds to support the HRMS project. Changes in project funding prohibit the SCO from charging the Federal Government for a portion of the application development costs prior to implementation; therefore, the SCO must reduce Federal Funding by $536,000 in 2007-08, and increase General Funding correspondingly. The remaining $460,000 requested would fund: (1) a Project Communications Manager ($93,000); (2) retention pay for staff on the HRMS project ($67,000); and (3) one-time training room build-out costs ($300,000). The SCO also proposes the following provisional language:

> 16. *The Director of Finance may authorize a decrease in expenditures for this item to reflect the final outcome of the retention pay proposal for the Human Resources Management System project. The Director of Finance may authorize an expenditure decrease per this provision not sooner than 30 days after notification in writing of the necessity to decrease the item is provided to the chairpersons of the committees in each house of the Legislature that consider appropriations and the Chairperson of the Joint Legislative Budget Committee, or his or her designee.*

Staff Comments: Staff has no concerns with the proposed funding shift or the training room build-out. The fund shift is necessary based on direction from the federal government, and the build-out funding is necessary to complete the training room project.

Regarding the Project Communications Manager, staff sees insufficient justification to warrant the addition of this position. The SCO has not adequately articulated the way in which current staff fail to meet the project's communications needs, and has not demonstrated with any high degree of specificity the added value a $93,000-per-year Communications Manager would provide.

Regarding the staff retention-pay request, staff notes the same concerns as voiced above in Issue #1, insofar as the proposal has not yet been approved by the DPA. While the language proposed (above) would make funding contingent upon DPA approval, staff notes concern that similar language has not been proposed for other pay increase proposals that lack DPA approval. If the Legislature is to seriously consider such language, it should be part of a larger discussion between the Department of Finance (Finance), the Department of Personnel Administration, and the Legislature, and should be used consistently. Staff notes, that when the Subcommittee heard the Salary Increase for Staff Management Auditors issue (see Issue #1 above) on May 9, 2007, Finance was requested to return at a future hearing prepared to have just such a discussion.

Staff Recommendation: APPROVE in-part. Approve the $536,000 funding shift from Federal to General Fund and the $300,000 one-time General Fund augmentation for training room build-out costs. DENY the Project Communications Manager, the retention pay for HRMS projec staff, and the proposed provisional language.

VOTE:

0950 State Treasurer's Office

The State Treasurer, a constitutionally established office, provides banking services for State government with the goals of minimizing interest and service costs, and maximizing yield on investments. The Treasurer is responsible for the custody of all monies and securities belonging to or held in trust by the State; investment of temporarily idle State monies; administration of the sale of State bonds, their redemption and interest payments; and payment of warrants drawn by the State Controller and other State agencies.

The Governor's budget funds 226.6 positions (with 4.0 new positions) and expenditures of $24.4 million ($6.6 General Fund).

VOTE-ONLY ISSUE:

1. April Finance Letter: Expanded General Obligation Bond Program Workload. The STO requests 4.0 permanent positions and $421,000 in reimbursement authority to address increased workload and complexity associated with issuance and refunding of general obligation (GO) bonds. Voters recently approved five new GO Bond measures totaling $42.7 billion.

Staff Comments: This issue was previously held open pending additional workload data from the STO. Based on information provided subsequently, staff no longer has concerns with this proposal

STAFF RECOMMENDATION ON VOTE-ONLY ISSUE 1: APPROVE the request.

VOTE:

DISCUSSION ISSUE:

1. May Revise Letter: Augment Personal Services Funding. The STO requests a $720,000 augmentation ($216,000 General Fund and $504,000 Reimbursement Authority) to fully fund authorized positions. According to the STO, existing funding is insufficient to fund personal services costs for all authorized positions, requiring the STO to maintain a 12 percent vacancy rate (on average over the past three years) to remain within budget.

Staff Comments: The STO indicates that the existing personal services budget is inadequate because of two primary reasons:

1. *Upgraded Positions Without Corresponding Funding Increase* – Although the STO handled approximately one-third more security investment transactions and sold twice as much in bonds in 2005-06 compared to 1990-91, the net increase in total staff over those 15 years was only 3.6 positions (225.4 to 229.0). The STO indicates that the additional volume and complexity of workload during this time was primarily addressed by upgrading key positions without corresponding increases in funding.

2. *Unallocated Reductions/Employee Compensation Increases* – The department was made to absorb multiple unallocated reductions and employee compensation increases dating back to the early 1990s.

Staff notes that this request highlights a very real dilemma for the Legislature, and an analytical challenge for staff. The STO makes a relatively compelling case—one that could perhaps be made by many state agencies—that 15 years of increasing workload, innumerable position re-classes, position increases and decreases, and unallocated reductions has cumulatively rendered the department's personal services budget inadequate to cover full staffing costs. However, short of undertaking an exhaustive and comprehensive analysis to re-baseline the personal services budget for the entire department, the calculus required to determine the STO's "true" need is difficult if not impossible to know. Put another way, the data necessary to completely validate or invalidate this request is simply not available.

In the absence of historical staffing, workload, and funding data, staff weighed the logic and credibility of the STO's overall case. First, the STO demonstrates a considerable growth in workload over time (noted above) that is not matched by a commensurate increase in staff (also noted above). This lends credence to the claim that the STO has necessarily had to rely on attracting, retaining, and promoting more experienced, more highly skilled staffers (who can handle more workload per position), and partially accounts for the expansion of personal services costs over time. Meanwhile, numerous unallocated reductions have no doubt eroded the personal services budget at STO, widening the gap between costs and available resources. The data provided by the STO (see Appendix A) testifies to this gap, reflected in a vacancy rate of between 9 and 14 percent over the past three years. In terms of reasonableness, the dollars requested reflect an additional need of approximately $36,000 per each of the 20 vacant positions that would need to be filled to achieve a 5 percent vacancy rate. Finally, the STO has identified new General Fund revenue totaling approximately $3.9 million annually (described in Appendix B) that would more than offset the additional funding requested.

Staff Recommendation: APPROVE the request, and score an additional $3.9 million in General Fund revenue.

VOTE:

1730 Franchise Tax Board

The Franchise Tax Board (FTB) administers state personal income tax and corporation taxes for the State of California, collects debt on behalf of other state agencies and local entities, and performs audits of campaign statements and lobbyist reports authorized by the Political Reform Act of 1974. The FTB is tasked to correctly apply the laws enacted by the Legislature; to determine the reasonable meaning of various code provisions in light of the legislative purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

The Governor's budget funds 5,174.5 positions (including 240.7 new positions) and expenditures of $623.4 million ($518 million General Fund).

VOTE-ONLY ISSUES:

1. May Revise Letter: Vehicle Registration Collection Augmentation. The FTB requests 24.0 two-year limited-term positions and $1.5 million ($1 million Motor Vehicle Licensing Fee Account and $500,000 Motor Vehicle Account) to meet increasing workload demands under the Department of Motor Vehicles (DMV) Collections Program.

2. May Revise Letter: California Child Support Automation System (CCSAS) Funding. The FTB requests a $724,489 increase in reimbursement authority to continue implementation and management of the CCSAS System.

3. April Finance Letter: CCSAS, Child Support Enforcement (CSE). The FTB requests a budget year (BY) increase of $30 million (and a corresponding BY+1 decrease) in reimbursement authority to reflect a revised rollout schedule for the CSE portion of the CCSAS project. The Department of Child Support Services is already budgeted to provide the reimbursement to FTB, therefore, this request would not result in any additional General Fund expenditures.

The following provisional language is contained in the Budget Act of 2006, and the FTB proposes to add it to the Budget Act of 2007 also:

> *Notwithstanding any other provision of law, upon request of the Franchise Tax Board, the Department of Finance may transfer any amounts not fully expended in Schedule (4)—Child Support Automation, to the Department of Child Support Services to provide for unanticipated costs associated with the California Child Support Automation System project. This notification may become effective no sooner than 30 days after providing notification in writing to the chairpersons of the fiscal committees of each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may in each instance determine.*

STAFF RECOMMENDATION ON VOTE-ONLY ISSUES 1 through 3: APPROVE the requests.

VOTE:

DISCUSSION ISSUE:

1. Provide Contractor Funding to Support Tax Agency Information and Data Exchange Assessment. Redirect $250,000 (General Fund) to fund a contractor in support of increased data-sharing between tax agencies.

Staff Comments: At a previous hearing, on April 19, the subcommittee reallocated a total of $865,000 that was budgeted for FTB Tax Gap Efforts, with $615,000 redirected to higher payoff activities and $250,000 reserved for potential funding of the technology consultant contract for the Tax Information and Data Exchange effort.

Staff suggests approval of the $250,000 redirection, plus the following Budget Bill language for Item 1730-001-0001 (FTB):

> *Of the amount appropriated in this item, $250,000 is for the Franchise Tax Board, working with the Board of Equalization, the Employment Development Department through the Fed/State Partnership, to contract for a technology consultant to explore existing technology solutions to increase data sharing efforts and promote compliance. The consultant's work shall emphasize Technology Identification and Development of A Collaborative Strategy, as described in the memorandum of April 27th, 2007 from the Fed/State Partnership to the Legislative Analyst's Office. The FTB, through the Fed/State Partnership shall report to the Legislature by March 15, 2008 on the status of the consultant contract and work product, and shall provide an update of the list of Future Data Sharing Efforts that was provided with the April 27th memorandum.*

The letter to the LAO (described above) is contained in Appendix C.

Staff Recommendation: APPROVE the redirection of the reserved $250,000 for a technology consultant and adopt the Budget Bill Language proposed above to specify the use of the funds and to provide a report to the Legislature.

VOTE:

1760 Department of General Services

The Department of General Services (DGS) provides management review and support services to state departments. The DGS is responsible for the planning, acquisition, design, construction, maintenance, and operation of the state's office space and properties. It is also responsible for the procurement of materials, data processing services, communication, transportation, printing, and security. The Governor's budget funds 3,703 positions (including 67.5 new positions) and $1.2 billion in expenditures, of which $9.2 million is from the General Fund.

VOTE-ONLY ISSUE:

1. May Revise Letter: Department of Motor Vehicles (DMV) – Custodial Services. The DGS requests 20.0 positions and $913,000 (Service Revolving Fund) to provide custodial services to the DMV at two locations.

Staff Comments: The DMV had planned to contract for custodial services with an outside vendor, but the State Personnel Board disapproved the request and it was subsequently determined that the DGS could provide services at these locations.

2. May Revise Letter: Fuel and Ongoing Preventative Maintenance Costs. The DGS requests $364,000 (Service Revolving Fund) to permanently fund fuel and ongoing maintenance costs for an168 additional vehicles procured in fiscal year 2006-07 under Provision 3 authority.

3. May Revise Capital Outlay Letter: Food and Agriculture Building Renovation Reappropriation. The DGS requests reappropriation of $20.8 million (Public Buildings Construction Fund) to allow sufficient time for the resolution, and potential payment, of a claim brought by a contractor on this project.

4. May Revise Capital Outlay Letter: Supplemental Appropriation for Structural Retrofit of the Department of Corrections and Rehabilitation (CDCR), DVI, Tracy, Hospital Building. The DGS requests an additional $1.2 million (Public Buildings Construction Fund) because the lowest bid for this project was 31 percent over the state's original estimate. This request reflects the additional construction phase-funding needed to match the average of the three bids received.

5. State Capitol and Grounds Maintenance and Repairs. The budget includes $1.2 million General Fund and 4.5 positions to conduct repair projects in the State Capitol and maintenance needs of the barrier system in Capitol Park.

6. State Capitol Security Funding. Provide an additional $1.2 million General Fund for State Capitol security.

7. State Capitol Maintenance and Repair. Provide $750,000 General Fund for State Capitol maintenance and repair projects.

8. BCP: California Highway Patrol (CHP) Enhanced Radio System. The budget includes 14.0 positions and $4.9 million (Service Revolving Fund) in 2007-08 and $9.4 million (Service Revolving Fund) in 2008-09 to facilitate the implementation of a new public safety radio communications system. All costs of this Budget Change Proposal have previously been identified and approved in a CHP BCP and will be recovered through billing the CHP.

9. April Finance Letter: Client Radio Replacement Program. The DGS requests 33.0 permanent positions and $3.9 million ($3.2 million ongoing) from the Service Revolving Fund for implementation of public safety communications requested in 2007-08 by the Department of Transporation (Caltrans) and Department of Corrections and Rehabilitation (CDCR). All costs associated with this request would be recovered through billing to Caltrans and the CDCR.

Staff Comments: The staff recommendation is to deny the CDCR client radio replacement. If the Subcommittee approves the staff recommendation in the CDCR budget, then this issue should be reduced accordingly.

STAFF RECOMMENDATION ON VOTE-ONLY ISSUES 1 through 9: APPROVE vote-only issues 1 through 8, and conform to actions on the CHP, Caltrans, and CDCR budgets for issues 9 and 10.

VOTE:

DISCUSSION ISSUES:

1. BCP: Augmentation for Building Security Services. The Administration requests $1.1 million (Service Revolving Fund) to fund increased costs contained in the Master Security Services Agreement for 15 state buildings. This agreement and procurement of private security services is overseen by the California Highway Patrol (CHP), who had previously provided security services for these buildings.

Staff Comments: This Subcommittee heard a similar issue last year and raised concerns that the state has no standard security requirement for its buildings, and that since 9/11 requests for security augmentations have occurred on a piecemeal basis—the state has no building security policy in place. Budget Bill Language was subsequently included to require the DGS to report on the nature and level of security expenditures at state-owned buildings of 50,000 square-feet or more. Staff notes that the report was due to the Legislature by March 15, 2007, but was not received until May 7 (requiring this issue to remain open until this May Revise hearing).

The report confirms that the CHP has conducted building security assessments in only 42 percent of the buildings (24 of 57) over the last six years. According to the DGS, these assessments were conducted in response to tenant requests, and are not part of a larger strategy to systematically evaluate state-building security needs on a common basis. However, the DGS indicates that discussions have begun between the department and the CHP to address this issue.

Questions for DGS:

1. Please describe for the Subcommittee the content of the discussions held thus far with the CHP on building security. What is the plan for next steps?
2. What end result or product does the DGS anticipate to come out of the talks with CHP, and what might this Subcommittee do to assist?

3. How can building tenants be brought into the development of security standards?

Contingent upon the responses to the above questions, the Subcommittee may wish to adopt the following Supplemental Report Language in order to ensure that the Legislature is kept apprised of developments on this issue and to allow the Subcommittee to take appropriate action during the next fiscal year's budget process:

> *No later than March 1, 2008, the Department of General Services shall provide to the Chairperson of the Joint Legislative Budget Committee and the chairpersons of the fiscal committees of each house of the Legislature, a report containing the following information: (1) the dates of meetings held between the department and the California Highway Patrol on the topic of state-building security; (2) minutes from each of the aforementioned meetings; (3) a summary of issues and/or problems raised in the meetings and an identification of whether they have been resolved or remain outstanding; (4) a plan for systematically assessing the security needs of state-owned buildings according to a uniform set of standards, or a timeline for developing such a plan with identification of the next steps necessary to meet the timeline.*

Staff Recommendation: APPROVE as budgeted with the Supplemental Reporting Language proposed above.

VOTE:

2. May Revise Capital Outlay Letter: Supplemental Appropriation and Request for Extension of Availability of Funds for Central Plant Renovation, Sacramento. The DGS requests an additional $82,734,000 (Public Buildings Construction Fund) and reappropriation of existing funding.

Staff Comments: This request would bring total project funding to $222 million, and reflects a 52 percent increase in costs over the original authorized budget. The DGS indicates these cost over-runs are the result of multiple factors, including the following:

1. ***Rapid escalation of costs for raw materials and labor*** – The original cost estimate was made in October 2002 and allowed for a cost escalation of 17 percent; however, the actual increase is 28 percent to date.
2. ***Escalation in pricing for design liability and construction risk*** – Since 2002, large lawsuits for design and construction deficiencies and accidents have driven up insurance premiums.
3. ***Project delay*** – The project has experienced delays in nearly every phase. Six months were lost because the state allotted insufficient funds to engage a design-builder during the proposal phase, and an additional five months was needed to obtain additional expenditure authority through the budget process. Other delays stemmed from the need to prepare separate Environmental Impact Reports due to the project's proximity to the West End Project. Finally, the DGS indicates that the initial construction duration estimate was overly optimistic and will now require an additional six months.

The cost of raw materials, labor, and liability and construction insurance, are not under the state's control, and estimating the interplay of these variables in estimating the cost of a project is an inexact science. However, to the extent project delays subject the state to greater uncertainty with regard to increasing costs for the above project inputs, it behooves the state to budget in a manner that will reasonably avoid delays. Staff notes that nearly a year was lost on this project because of insufficient funding, during which time the cost increases noted above “cascaded.” Some of these additional costs might have been avoided had project funding been sufficient to engage a design-builder immediately.

The Subcommittee may wish to inquire of the DGS and DOF about the margin of error built into large capital outlay projects when cost increases are built into cost estimates.

Questions for DGS/DOF:

1. What is the percent cost increase currently built into capital outlay cost estimates? Has recent experience matched these projections?
2. Would an incrementally larger cost-increase estimate (of, say, an additional 5 percent) have allowed this project to go forward without the 11-month delay?

Finally, the LAO recommends adoption of the following Budget Bill Language to ensure the requested funds are used for the proposed purpose only.

Provisions:

1. *After execution of a design-build contract, any funds provided in this item for design build contracts in excess of the executed amount of the contract shall be immediately reverted and shall no longer be available for expenditure.*

Staff Recommendation: APPROVE the request with the LAO-recommended Budget Bill Language (above).

VOTE:

8885 Commission on State Mandates

The Commission on State Mandates is a quasi-judicial body that makes the initial determination of state mandated costs. The Commission is tasked to fairly and impartially determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state.

The Governor's budget funds 14 positions (with no new positions). No budget change proposals were submitted by the department.

DISCUSSION ISSUES:

1. May Revise Letter: Payment of New Claims. The Administration requests reappropriation of $41 million (General Fund) from the local government mandates payment appropriation in the 2006-07 Budget Act ($232.5 million). This reappropriation is requested to pay additional claims for costs incurred in the 2004-05, 2005-06, and 2007-08 fiscal years and to pay for the statewide cost estimates for two newly determined mandates. Most of these claims are for costs incurred in 2004-05. This reappropriation would be available for expenditure for two years. Payment of these claims generally is necessary to avoid the suspension requirement of Proposition 1A.

Staff Comments: Although the state needs to fund the additional claims noted above, staff notes the following concerns:

1. ***Reappropriation Should Be Limited to One Year.*** There is no need to provide two-year funding for these past claims. The amount of overall outstanding mandate claims should be re-evaluated each year. Having multiple overlapping appropriations creates unnecessary complications.

2. ***Peace Officer Procedural Bill of Rights (POBOR)* Claims should *be Excluded.*** As proposed, the language of the reappropriation would authorize payment of past POBOR claims because the reappropriated item included $16 million each year for POBOR claims in 2005-06 and 2006-07. However, POBOR is not subject to Proposition 1A's suspension requirement, and remaining unpaid POBOR claims are handled as part of the annual payment of deferred mandate claims.

3. ***Existing Provisional Language Is Superfluous.*** Item 8885-295-0001 of the 2007-08 Budget Bill includes a provision allowing the Director of Finance to augment the item to pay any unpaid claims for 2006-07 mandate costs. This open-ended spending authority would not appear to be necessary in light of the proposed reappropriation. The specific language that should be deleted is Provision 1:

   > *~~If the amount in Schedule (1) of Item 8885-295-0001 of the 2006 Budget Act (Ch. 47, Stats.2006) is insufficient to pay claims for costs incurred to carry out the cited state mandates in the 2006–07 fiscal year, the Controller shall notify the Director of Finance of the amount of the deficiency and, with the approval of the director, shall augment the amount in Schedule (1). The director shall notify the Chairperson of the Joint Legislative Budget Committee and the chairpersons of~~*

~~*the fiscal committees in both houses of the Legislature prior to authorizing any augmentation pursuant to this provision.*~~

Staff Recommendation: ADOPT the reappropriation in the Finance Letter with the following modifications:

1. Limit to one year (not two).
2. Exclude POBOR from the reappropriation.
3. Delete Provision 1 in the existing Budget Bill language.

VOTE:

2. Mandate Reform Trailer Bill Language. The Administration proposed trailer bill language to reform the mandate process.

Staff Comments: The Subcommittee heard discussion on the competing Administration and LAO mandate reform proposals on March 8, and recognized the need for additional talks to identify a "compromise" reform package. However, subsequent discussions have not produced a clear plan on which the Subcommittee might take action, and the issue appears to have moved out of the budget process and into the policy process, with an LAO reform bill (AB 1576, Silva) passing out of the Assembly and currently being considered by the Senate.

Staff Recommendation: Formally DENY the trailer bill language.

VOTE:

3. Technical Cleanup Trailer Bill Language. Commission staff, along with the LAO, Department of Finance, and the State Controller's Office have been developing technical cleanup Trailer Bill Language in response to direction of the Subcommittee at its April 24th hearing. The LAO has pointed out that the current budget funding approach for mandates is not consistent with existing statutory mandate claiming and payment provisions. For example, statute calls for claims to be paid on a current basis each year, while the budget calls for 2007-08 claims to be paid in the following year, as permitted under Proposition 1A. Also, existing law calls for an annual Mandate Claims Bill, while current practice is to fund mandates through the annual Budget.

Staff Comments: Staff suggests that the Subcommittee adopt the language developed by the various staffs as placeholder Trailer Bill Language. This will enable the language to be circulated to local governments, education organizations, and other interested parities to enable any errors, omissions, or unintended effects to be corrected.

Mandate Reform (in contrast to technical cleanup) is being addressed in legislation through the policy process.

Staff Recommendation: ADOPT DOF mandate technical cleanup language as placeholder Trailer Bill Language.

VOTE:

8940 Department of the Military

The California Military Department (CMD) is responsible for the command, leadership, and management of the California Army and Air National Guard and five other related programs. The purpose of the California National Guard is to provide military service supporting this state and the nation. The three missions of the California National Guard are to: (1) supply mission ready forces to the federal government as directed by the President; (2) provide emergency public safety support to civil authorities as directed by the Governor; and (3) support local communities as directed by proper authorities. The CMD is organized in accordance with federal Departments of the Army and Air Force staffing patterns. In addition to the funding that flows through the State Treasury, the CMD also receives Federal Funding directly from the Department of Defense.

The Governor's budget funds 780 positions (including 95 new positions) and expenditures as follows:

Summary of Expenditures (dollars in thousands)	2006-07	2007-08	$ Change	% Change
Fund Source				
General Fund	$42,330	$44,829	$2,499	5.9%
Armory Discretionary Improvement Account	146	150	4	2.7
Armory Fund	1,425	0	-1,425	-100.0
Federal Trust Fund	68,544	70,548	2,004	2.9
Reimbursements	15,286	15,610	324	2.1
California Military Family Relief Fund	250	250	0	0.0
Total	$127,981	$131,387	$3,406	2.7%

VOTE-ONLY ISSUE:

1. May Revise Capital Outlay Letter: Minor Projects. The Department of the Military requests budget authority to reappropriate funding ($391,000 General Fund) for the department's minor capital outlay projects (e.g. kitchen, latrine, and lighting upgrades) funded in the Budget Act of 2006. The Military Department utilizes the Army Corps of Engineers (Corps) to design and manage these projects; however, the Corps was unavailable for this project in 2005-06 due to Hurricane Katrina (requiring reappropriation for 2006-07) and were in high demand again in the current fiscal year because of the war in Iraq.

STAFF RECOMMENDATION ON VOTE-ONLY ISSUE 1: APPROVE the request.

DISCUSSION ISSUE:

1. May Revise Capital Outlay Request: Headquarters Complex. The Department of the Military requests budget authority to reappropriate funding ($775,000 General Fund) for the acquisition phase of the department's new headquarters complex (to be located on 30 acres at the former Mather Air Base). The Military also proposes the following Budget Bill Language to allow the State Public Works board to augment the acquisition phase-appropriation by up to 30 percent:

> *1. Notwithstanding Section 13332.11 of the Government Code, the State Public Works Board may augment the amount appropriated for the Consolidated Headquarters Complex project in Schedule (1) of Item 8940-301-0001, Budget Act of 2006, by up to 30 percent. Upon the receipt of future Budget Act authority for this project, the cumulative amount augmented may not exceed 20 percent of total appropriations.*

Staff Comments: According to the Department of Finance, this reappropriation is not strictly necessary because there are still two years remaining to encumber the original capital outlay appropriation. However, the reappropiation item is requested as a technical means of ensuring that the proposed provisional language is applied only to this project (and not other projects funded in the original item of appropriation). The provisional language is intended to ensure that adequate funds are available for the Military to secure property at the desired location (which holds many advantages for the department over other alternatives) but to still require the project to remain within the standard 20 percent augmentation cap.

The LAO notes concern that the Administration proposal could set a precedent which would encourage other departments to request similar provisional language. In this instance, an additional 10 percent would only amount to $100,000; however, if applied to larger projects in the future, this type of language could lead to millions of dollars in augmentations, greatly reducing legislative oversight of capital outlay expenditures.

Notwithstanding these concerns, the Subcommittee may wish to provide the department with the additional expenditure authority it asserts is necessary to secure acquisition of the desired project site. An alternative approach that would address both the LAO's and the Military's concern would be to increase item 8940-301-0001 by $100,000 to provide additional acquisition authority. The following schedule would ensure that the dollars were used strictly for the acquisition phase of the Headquarters Complex project:

> *((0.5) 70.22.015-Consolidated Headquarters Complex: Acquisition............ 100,000)*

Additionally, the following Budget Bill Language would tie the augmentation to the original appropriation and make the dollars easier to track in the future:

> Item 8940-301-0001
> Provisions:
>
> *XX. Funding provided in Schedule (0.5) of this item is to be used in a manner consistent with the conditions provided in Provision 1 of Item 8940-301-0001, Budget Act of 2006.*

Staff Recommendation: DENY the May Revise request, and APPROVE a $100,000 General Fund augmentation to the project acquisition phase appropriation and Budget Bill Language (as described above).

VOTE:

9618 Economic Recovery Financing Committee

The Administration proposes a $595 million supplemental repayment of Economic Recovery Bonds (ERBs) in order to fully pay them off by August 1, 2009, five months ahead of previous projections. The Administration estimates this proposal would save almost $90.9 million in simple interest and make available an additional $701 million General Fund in 2009-10 that would otherwise be used to reimburse local governments for the Triple Flip.

Staff Comments: This proposal represents a trade-off between General Fund now and General Fund later—it would significantly reduce the amount of General Fund available to address the state's most pressing needs today in order to free up a marginally greater amount of General Fund in the future. While reducing debt service generally benefits the state's bottom line in the long-run, the LAO notes that ERBs represent relatively low-cost debt and points out that extending the repayments of the ERBs would be preferable to paying them off early only to incur new, higher-cost debt (for example, pension obligation bonds). Based on the LAO Analysis, the Subcommittee may wish to deny this proposal and forego the expected debt service savings in order to meet more immediate needs like balancing the 2007-08 budget and maintaining a prudent General Fund reserve. Staff notes that in its report on the May Revise, the LAO estimates the Administration has overstated the General Fund reserve by $1.7 billion.

Staff Recommendation: DENY the proposal, and score $595 million in General Fund savings.

VOTE:

Control Sections

VOTE-ONLY ISSUES:

1. May Revise Letter: Amendment to Control Section 4.30, Lease-Revenue Payment Adjustments. The Administration requests a $4.4 million (General Fund) increase to this control section for the payment of lease-revenue debt service in fiscal year 2007-08 resulting from accelerated bond sales for the Office of Emergency Services Los Angeles Crime Lab. The control section would allow the Director of Finance to adjust amounts in appropriation items for rental payments on lease-purchase and lease-revenue bonds if budgeted costs change during the 2007-08 fiscal year. The Administration proposes to reflect the requested augmentation as a set-aside and to process an executive order once the Budget Act has been signed.

Staff Recommendation: APPROVE the request.

2. May Revise Letter: Control Section 4.85, Disposition of Remaining 1993 Series A and 1998 Series B Public Works Board Energy Bond Proceeds. The Administration proposes this control section to authorize the remaining bond proceeds from the 1993 Series A and the 1998 Series B Public Works Board Energy Bonds to be swept to the General Fund. The bond debt from these bonds has been retired and approximately $5.1 million in remaining funds have been identified as surplus.

Staff Recommendation: APPROVE the request.

3. May Revise Letter: Control Section 15.25, Appropriation Adjustments to Reflect Technology Service Rate Changes. The Administration proposes this control section to authorize the Director of Finance to adjust appropriation items to reflect cost changes resulting from mid-year adoption of new Department of Technology rate adjustment packages. The Administration estimates that the net savings from 2007 rate changes would be approximately $26.7 million statewide, including $7.3 million General Fund and $19.4 million special fund.

Staff Recommendation: APPROVE the request.

STAFF RECOMMENDATION ON VOTE-ONLY ISSUES 1 through 3: APPROVE the requests.

VOTE:

DISCUSSION ISSUES:

1. April Finance Letter: Control Section 4.04, "Price" Reduction. The Administration proposes this Control Section to allow the Director of Finance to reduce all General Fund items of appropriation by an amount not to exceed a total of $46.3 million.

Staff Comments: The Governor's Budget includes a $100 million unallocated reduction (see Control Section 4.05 below); however, the additional reduction contained in this control section was proposed when an arbitrator's ruling awarded the California Correctional Peace Officers Association an additional pay increase (on top of one already contained in the budget). The $46.3 million reduction proposed is roughly equivalent to half of the price increase granted to departments in the Governor's Budget.

Given the random havoc past unallocated reductions have wrought on departmental budgets (see STO, Discussion Issue #1 for an example), the Subcommittee may wish to minimize the impact of Control Section 4.05, by simply eliminating the price increase altogether (augmenting this proposal by $46.3 million for a total price reduction of $93 million). The following language would accomplish this purpose, and allow the unallocated reduction in Control Section 4.05 to be reduced by a corresponding amount (bringing it to $53.7 million):

> *SEC. 4.04. Notwithstanding any other provision of law, no General Fund baseline price increase adjustment shall be provided to any state department, agency, or bureau in the 2007 Budget. This section does not apply to the Legislature, Constitutional Officers, and the Judicial Branch.*

Staff Recommendation: APPROVE the revised Control Section 4.04 language (above), eliminating the price increase, and bringing the overall impact of the control section to a $93 million reduction.

VOTE:

2. Control Section 4.05, Unallocated General Fund Reductions. This Control Section is intended to generate $100 million in budget year savings through unspecified reductions in departments' budgets. The Director of Finance (Director) may provide agency secretaries with target reduction amounts and may solicit recommended reductions from the agencies, but the Director would have ultimate discretion over the amount of the reductions. Additionally, this control section places limits on the percent reduction that may be applied to any state operations or local assistance appropriation, and requires reporting to the Legislature of the final reduction amounts.

Staff Comments: See the comments above in Issue #1

Staff Recommendation: DECREASE the unallocated reduction contained in this control section by $46.3 million. The revised control section would authorize a $53.7 million unallocated reduction.

VOTE:

3. Control Section 28.00, Program Change Notification. This control section compliments Section 8.50 (see below) and authorizes the Director of Finance to augment an appropriation mid-year if unanticipated federal or other non-state funds become available provided the funding meets the following requirements: (1) the funds will be used for a purpose consistent with state law; (2) the funds are made available for a specified purpose and will be used for that purpose; (3) acceptance of the funds does not impose upon the state a requirement to commit or expend new state funds; and (4) the need exists to expend the additional funding during the 2007-08 fiscal year. The control section also specifies the circumstances under which a mid-year augmentation must be reported to the Legislature.

Staff Comments: In the fall of 2006, the Legislature hosted a Department of Finance-organized "training" department staff to clarify expectations regarding the implementation of this and other Budget control sections. At that time, legislative staff highlighted past misuse and abuse of Section 28.00 and placed special emphasis on the need to submit reports to the Legislature in a timely fashion and only for unanticipated funds. However, continued late reporting triggered a letter from the Senate Budget Committee Chair to the Director of Finance requesting the convening of a staff workgroup to discuss whether Section 28.00 should be modified to ensure appropriate legislative oversight.

Staff notes that, to date, workgroup discussions have not borne specific solutions to ensure departments notify Finance of additional federal funds in a timely manner, and Finance, in turn, notifies the Legislature in a timely manner. At this late stage in the budget process, the Subcommittee may wish to delete Section 28.00 and its counterpart, Section 8.50, in order to send this issue to conference for additional discussion.

Staff Recommendation: DELETE Control Section 28.00.

VOTE:

4. Control Section 8.50, Federal Funds Receipts. This control section appropriates any federal funds received during the budget year, subject to any provisions of the Budget Act that apply to the expenditure of the funds, including Section 28.00.

Staff Comments: See comments for Issue #6 above.

Staff Recommendation: DELETE Control Section 8.50.

VOTE:

5. Control Section 35.60, Budget Stabilization Account Transfer to the General Fund. Proposition 58, approved by the voters in the March 2004 primary election, enacted a balanced budget requirement, established a process for the Governor to declare a fiscal emergency and call the Legislature into special session to take mid-year corrective action to keep the budget in balance, and also created the Budget Stabilization Account (BSA).

Staff Comments: The Subcommittee previously deleted this control section, as did Assembly Budget Subcommittee #4. However, in acknowledgement of the fact that the LAO's analysis of the May Revise projects an insufficient General Fund reserve, the Subcommittee may wish to adopt the control section, but do so in such a way as to send it to conference for additional consideration.

Staff Recommendation: RESCIND the previous Subcommittee action and APPROVE the control section with an amendment to section (b). The revised version would change the 15 day notification period to "14 days."

VOTE:

APPENDIX B – STO Description of New General Fund Revenue

The STO is the legal custodian for securities pledged as collateral to the State by companies operating or performing a particular business or function in the State, as required by various laws under State Agencies such as the Departments of Insurance, Industrial Relations, Transportation, and the California State Universities. As Custodian since the 1940's, Citibank is responsible for holding these investments and pledged securities in separate accounts.

As custodian bank, Citibank is responsible for collecting the interest payments for bonds and securities pledged as collateral to the state from the Paying Agent and crediting the funds to the owner. Upon authorization from the STO, Citibank wires the funds to the owner. Occasionally, companies will change banks or bank accounts and not inform the STO. When this occurs, the funds are returned to Citibank, and held until the STO receives updated wire instructions from the company.

Similarly, when bonds and securities pledged as collateral are called or matured, Citibank collects the funds from the Paying Agent and credits them to the owner. The STO informs the company that the bond or security has been called or matured and that it must be replaced. The company is also informed that the bond or security is no longer earning interest. In order for the company to receive the cash, the company must replace the matured or called bond or security held as collateral with a new one. When securities pledged as collateral are called or matured, the interest payments cease and the security is converted to cash and held at Citibank until the company purchases a replacement security.

In all previous Custodial Services Agreement's, there was no mention of how to allocate the earnings of the Citibank account cash balances. When the Agreement was renewed in July 2006, additional language was added to specify that the STO would be paid interest on the cash balances until the STO received a transaction request from the company to release or exchange the funds. The calculation of the interest earned on these cash balances is: Overnight London Interbank Offering Rate (LIBOR) minus 37.5 basis points divided by three hundred and sixty (360) days.

The STO estimates that over the next 5 years (the term of the Agreement) these earnings would minimally total $15 million (an average of $250,000 per month).